No. 77-1373

In the Supreme Court of the United States

OCTOBER TERM, 1977

MAINE CENTRAL RAILROAD COMPANY, APPELLANT

v.

RAYMOND L. HALPERIN, ET AL.

ON APPEAL FROM THE SUPREME JUDICIAL COURT OF MAINE

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

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MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

This memorandum is filed in response to the Court's invitation of May 15, 1978.

QUESTION PRESENTED

We address the question whether application of the Maine Railroad Excise Tax to incentive per diem income received by appellant conflicts with the Interstate Commerce Commission's incentive per diem program, and therefore is forbidden by the Supremacy Clause of the United States Constitution.

STATEMENT

A. The Interstate Commerce Commission's Incentive Per Diem Program

To remedy a critical freight car shortage during World War I, Congress enacted the Esch Car Service Act of 1917, 40 Stat. 101, 49 U.S.C. (1964 ed.) 1(14) (a). This statute empowered the Interstate Commerce Commission to prescribe compensatory per diem charges to be paid by railroads using boxcars owned by other carriers. See *United States* v. *Allegheny-Ludlum Steel Corp.*, 406 U.S. 742, 743-744.

Perceiving that the supply of boxcars remained inadequate despite the incentives that had been created by those compensatory per diem charges, Congress authorized the Commission in 1966 to prescribe additional per diem payments. See *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, 230-231. Under Section 1(14)(a) of the Interstate Commerce Act, as amended in 1966, 80 Stat. 168, 49 U.S.C. 1(14)(a), the Commission was authorized to fix per diem compensation in light of the following considerations:

> the Commission shall give consideration to the national level of ownership of such type of freight car and to other facts affecting the adequacy of the national freight car supply, and shall, on the basis of such consideration, determine whether compensation should be computed solely on the basis of elements of ownership expense involved in owning and maintaining such type of freight car, including a fair return on value, or whether such compensation should be increased by such incentive element or elements of compensation as in the Commission's judgment will provide just and reasonable compensation to freight car owners, contribute to sound car service practices (including efficient utilization and distribution of cars), and encourage the acquisition and maintenance of a car supply adequate to meet the needs of commerce and the national defense. * * *

The concern of Congress about the shortage was expressed in the report of the Senate Committee on Commerce on the 1966 amendment:

> Car shortages, which once were confined to the Midwest during harvest seasons, have become increasingly more frequent, more severe, and nationwide in scope as the national freight car supply has plummeted. [S. Rep. No. 386, 89th Cong., 1st Sess. 1-2 (1965).]

Using the authority vested in it by the 1966 amendment, the Commission established a comprehensive incentive per diem (IPD) program with respect to plain unequipped boxcars. See *Incentive Per Diem Charges—1968*, 337 I.C.C. 217 (1970). The Commission's IPD regulations are presently codified in 49 C.F.R. Part 1036, and they have been upheld by this Court.[1]

The regulations prescribe a level of payments that, in the judgment of the Commission, will contribute to sound car service practices and encourage the

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[1] See *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, on remand, 368 F. Supp. 1009 (M.D. Fla.), affirmed, 417 U.S. 901. See also *Illinois Terminal R.R.* v. *United States*, 541 F.2d 201 (C.A. 8), certiorari denied, 430 U.S. 906.

acquisition and maintenance of an adequate car supply. The Commission sought to increase the annual rate of return on investments in unequipped boxcars from 6 percent to 12 percent. It concluded that this relatively high return is necessary to make investment in boxcars a "desirable alternative" to various available business investments. *Incentive Per Diem Charges—1968*, *supra*, 337 I.C.C. at 224.

The incentive per diem regulations further provide that net balances of IPD receipts collected by carriers, less federal and state income taxes actually paid as a result of receiving such payments, must be segregated and expended only to purchase, build, rebuild or lease boxcars. 49 C.F.R. 1036.3. As the Commission made clear, "[t]he net balances derived from the incentive charge are not properly part of the general working capital of the recipient railroad." *Incentive Per Diem Charges—1968*, *supra*, 337 I.C.C. at 228. Rather, such receipts are "in effect, held in trust" for use in augmenting the nation's supply of boxcars. *Incentive Per Diem Charges—1968*, 343 I.C.C. 49, 56 (1973). Once the funds have been used to purchase boxcars, however, the boxcars become the unencumbered property of the railroad.

Moreover, a carrier must acquire its "test period quota" of boxcars each year with general corporate funds before expending IPD funds to purchase additional boxcars. To satisfy that quota, the carrier must build, lease, or purchase the number of boxcars that, on the average, it had built, leased, or purchased each year from 1964 through 1968. 49 C.F.R. 1036.4.

This requirement ensures that boxcars acquired with IPD funds are in addition to boxcars that would have been purchased by the carrier in the ordinary course of business. *Incentive Per Diem Charges—1968*, *supra*, 337 I.C.C. at 228-230.

B. The Present Proceedings

Appellant operates a railroad with lines in Maine, and it is subject to the Maine Railroad Excise Tax, 36 Maine Rev. Stat. Ann. 2623-2628 (1965), as amended (J.S. App. 35a-39a).[2] In 1974 appellant received approximately $1,870,000 in IPD income from other carriers that had used its boxcars (J.S. 10). The State Tax Assessor included that sum in the appellant's net railway operating income (NROI) for purposes of calculating the applicable Maine Railroad Excise Tax. The State Tax Assessor determined that appellant's tax liability for 1975 should be $686,383; the tax liability would have been $70,623 if IPD pay-

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[2] The tax liability of a railroad under the Maine excise tax is based on a percentage of the railroad's gross transportation receipts for the preceding year. The applicable percentage is ascertained by comparing the railroad's net railway operating income for that year with the railroad's gross transportation receipts. (See the appendix to the Mot. to Dismiss or Affirm for a description of those two accounting terms.) When the net railway operating income is 10 percent or less of the gross transportation receipts, the applicable tax percentage is 3¼ percent of the gross transportation receipts. But when the net railway operating income exceeds 10 percent of the gross transportation receipts, the applicable percentage rises and the tax liability is accordingly increased (J.S. App. 2a-3a).

ments had been excluded from the NROI account (J.S. 10-11).[3]

Appellant then brought suit in the Superior Court for Kennebec County, Maine, seeking a declaratory judgment that IPD payments could not properly be included in NROI, and that, if the statute were construed to include IPD payments within the definition of NROI, the statute, as applied, violated the Supremacy Clause of the United States Constitution. The Interstate Commerce Commission filed a brief as *amicus curiae* and supported appellant. The case was certified to the Supreme Judicial Court of Maine for determination on a statement of stipulated facts.

The Commission's brief in that court argued that the state tax should not be interpreted to include IPD receipts in NROI, because that would undermine the IPD program. The Commission explained that receipts must be segregated and expended for the limited purpose of increasing the number of boxcars in the nation's railroad system. By imposing substantial excise tax liabilities on the general corporate funds of railroads receiving IPD payments, the Commission argued, the state either had levied a tax on the IPD monies themselves (which, in the Commission's view, it could not do) or had made it more difficult for the railroads to meet their "test period quota" of new

[3] The inclusion of IPD payments in the Maine Central's 1974 NROI account moved Maine Central into the higher, $3\frac{3}{4}$ percent tax bracket. It also affected the computation of deductions and exclusions. The latter effect was apparently more important for appellant's 1975 taxes.

cars (see pages 4-5, *supra*), which must be acquired with general corporate funds before IPD funds can be used for additional purchases. This not only created a disincentive, the Commission contended, but also diminished the amount of money available to purchase new boxcars as contemplated by Congress.

The Supreme Judicial Court of Maine rejected the contentions of the Commission, holding that (J.S. App. 16a-17a; footnote omitted; emphasis in original):

> [W]e are satisfied that Maine's inclusion of incentive per diem charges in net railway operating income, for the computation of the Maine excise tax on railroads, has no direct, generalized tendency to affect the federal boxcar incentive program so adversely as to require, by force of the Supremacy Clause of the Constitution of the United States, the nullification of that particular exercise of Maine's power of taxation *by implication* from the existence, and needs, of the Federal program.

DISCUSSION

1. The Interstate Commerce Commission adheres to the views it expressed in the Supreme Judicial Court of Maine. The Commission concurs in the arguments set forth at pages 14-23 of the jurisdictional statement of appellant, which it believes require elaboration only by reference to *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414, 428-429, and *Warren Trading Post Co.* v. *Arizona Tax Commission*, 380 U.S. 685,

691, in which this Court held state tax statutes to be preempted.[4]

2. The United States disagrees with the Commission and concludes that the Maine tax is not preempted. This Court has indicated that state taxes are not lightly to be set aside on grounds of implied preemption. Thus, in *Hines* v. *Davidowitz*, 312 U.S. 52, 68, the Court, while finding a state alien registration statute to be inconsistent with applicable federal legislation, emphasized that state taxation statutes fall within "an entirely different category," and that the states enjoy a "broad base" in levying taxes on local business operations.[5]

The Court stated in *Merrill Lynch, Pierce, Fenner & Smith* v. *Ware*, 414 U.S. 117, 139, that " 'federal

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[4] The Commission believes that the Supreme Judicial Court of Maine was wrong in assuming (J.S. App. 16a) that railroads, subject to excise tax liabilities payable out of general corporate revenue, will voluntarily surrender IPD receipts to the "Rail Box" corporation if they should be unable to meet their test period quota of new boxcar purchases and are therefore unable to expend such IPD receipts. No railroad has voluntarily tendered IPD funds to Rail Box; IPD receipts are of considerable value to railroads when converted into rolling stock, and railroads will not readily forego that value.

[5] The Court in *Hines* cited Federalist paper 32, which states that, notwithstanding the Supremacy Clause, the states retain a broad and independent power to raise revenue to any extent of which they may stand in need by every kind of taxation except duties on imports and exports. See also Federalist papers 33 and 34, emphasizing that, in the absence of an immediate constitutional repugnancy, the Supremacy Clause does not abridge state power to levy taxes. See *The Federalist* 240-253 (Wright ed. 1961).

regulation of a field of commerce should not be deemed preemptive of state * * * power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained'." See also *Braniff Airways, Inc.* v. *Nebraska State Board of Equalization*, 347 U.S. 590, 594-597; *DeCanas* v. *Bica*, 424 U.S. 351, 355-358. And as the Court pointed out in *Exxon Corp.* v. *Governor of Maryland*, No. 77-10, decided June 14, 1978, slip op. 12-13: "[i]n this as is other areas of coincident federal and state regulation, the 'teaching of this Court's decisions * * * enjoins seeking out conflicts between state and federal regulation where none clearly exists.' "

Although a state statute may not stand as " 'an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' " *Ray* v. *Atlantic Richfield Co.*, No. 76-930, decided March 6, 1978, slip op. 5, the state rule is not preempted unless federal policies actually have been "thwarted" by the "practical operation" of the state statute. *First Federal Savings & Loan Association of Boston* v. *State Tax Commission*, No. 77-334, decided June 15, 1978, slip op. 4. Preemption of an otherwise valid law by implication is rare, because the federal government, through corrective legislation or administrative rulemaking, "remains free to remove the burden" on federal programs that may result from state legislation. *Penn Dairies, Inc.* v. *Milk Control Commission*, 318 U.S. 261, 275. Preemption by implication should be an

extraordinary event indeed when a state tax statute is involved. This follows not only from the caveat in *Hines* but also from the fact that all taxes make the thing taxed less profitable. The federal government regulates (or encourages) many activities. If the disincentive[6] to investment that might be caused by a state tax were enough to preempt the state tax's application to any subject regulated (or encouraged) by federal agencies, much of the states' power to tax would be ousted. Only the plainest command could support such a result.

3. Those principles, applied to the Maine tax and its effect on appellant, lead to the conclusion that the taxation of IPD receipts (and their inclusion in appellant's NROI account) are consistent with the Supremacy Clause of the Constitution.

First, the Commission's regulations do not state expressly that IPD receipts must be disregarded for purposes of state excise tax computation. Indeed, those regulations allow both state and federal income taxes to be paid directly out of the railroad's segregated IPD account. See *Incentive Per Diem Charges —1968*, 343 I.C.C. 49, 55 (1973). Thus, the regulations themselves do not support the argument that state excise tax liability was foreclosed by the Commission in the present circumstances. Nothing of con-

[6] A state tax is a disincentive in the sense that it reduces the absolute attractiveness of profit-making endeavors. But a neutral or flat-rate tax on receipts or profits leaves the *relative* attractiveness of investments unaffected. Moreover, a state rarely would seek to discourage such profit-making endeavors, because that would obliterate the very thing (profits or receipts) from which the state sought to raise revenue.

stitutional dimension should turn on whether a state elects to raise revenue through an income tax (which the federal regulation contemplates), through an excise tax, or through some combination of taxes; any of those routes can lead to the same net tax.

Second, the Maine tax is neutral with regard to federal purposes. It applies to a percentage of the gross transportation receipts of the railroad. The applicable percentage of the gross transportation receipts is determined by reference to the ratio between the railroad's NROI and its gross transportation receipts. IPD income is only one constituent in the NROI account, and it is treated exactly like any other item of net revenue.[7] The tax in question does not penalize IPD receipts or subject them to a discriminatory or disproportionate rate of taxation. Cf. *United States* v. *County of Fresno*, 429 U.S. 452, 462-464. If the state imposed a tax on boxcar revenues higher than its tax on other railroad receipts, this would be a very different case.

Third, appellant easily can comply with both the state and federal provisions. The federal rule gener-

[7] It therefore would not be accurate to contend that the IPD income of appellant caused either the increase in the applicable tax percentage or the change in the computation of deductions and exclusions that led to the especially high tax in 1975. The NROI account includes various income constituents, and no single constitutent can logically be isolated as the marginal factor that caused the higher taxes. The IPD funds and (say) locomotive rentals are treated identically by the state, and the exclusion of either from the tax computations would have decreased the tax.

ates money; the state rule taxes profits from remunerative activity. It is quite true that participation in the IPD program generates income for the purpose of encouraging the ownership of boxcars, but income-producing activities are traditionally subject to state taxation, as the Commission's own regulations acknowledge. And it is equally clear that the state tax does nothing to upset the relative investment priorities implicit in the Commission's IPD program. If boxcar rentals result in a rate of return of 12 percent, which is equal to or above the rate of return available on alternative forms of railroad investment, then the imposition of a neutral tax based on a percentage of the railroad's gross transportation receipts will not diminish the relative attractiveness of boxcar investments vis-a-vis other types of business investment. The return available on boxcar investments will still be more attractive than lower rates of return available on alternative investments, no matter how high the state tax may be (so long as it does not reach 100 percent).

4. We also conclude that the arguments of appellant regarding the disincentives generated by the state tax are not clearly supported by the record. "The sparse evidence introduced on this point * * * is ambiguous at best." *First Federal Savings & Loan Association*, *supra*, slip op. 4 n. 4. Appellant has continued to increase its supply of boxcars (see Mot. to Dismiss or Affirm 6-8),[8] and there is no showing

[8] This is, we think, the almost inevitable consequence of the fact that the Commission has made investments in boxcars

that appellant had insufficient cash, liquid assets, or ability to obtain credit to meet its test period quota in any year. See also J.S. App. 13a n. 8. In addition, as the court below pointed out," [t]he year 1974 was unusual" because of appellant's record earnings (J.S. App. 12a), resulting in an unprecedented increase in appellant's tax bracket. The inclusion of IPD receipts in appellant's NROI account evidently did not increase its tax liability in any preceding year.

With respect to appellant's argument that a railroad subject to excise tax liability payable out of general corporate funds may be prevented from meeting its "test period quota" and thus be barred from expending IPD receipts for new boxcars, we observe that this record does not indicate that appellant has been unable to meet its quota or that such a situation is likely to result recurrently or in a substantial number of other cases with a disruptive effect on the federal IPD program. See *Exxon Corp.* v. *Governor of Maryland*, *supra*, slip op. 12-13: " 'the existence of such potential conflicts is entirely too speculative in the present posture of this case' * * * This sort of hypothetical conflict is not sufficient to warrant preemption."[9]

especially profitable. If it ever were in the interest of appellant to reduce its investments in order to avoid state taxes, surely appellant would eliminate its least profitable investments first.

[9] The Commission relies on *McGoldrick*, *supra*, and *Warren Trading Post Co.*, *supra*, as cases in which this Court found an implied preemption of state taxes. (Appellant cites no

We emphasize once more that this is not a case in which a federal administrative agency has adopted an explicit rule or regulation governing the application of state excise taxes. Where an express prohibition exists under a valid federal regulation, the Supremacy Clause would require that the regulation take precedence over conflicting state laws. See *McGoldrick* v. *Gulf Oil Corp.*, *supra*, 309 U.S. at 426-429; *Free* v. *Bland*, 369 U.S. 663, 666-670; *United States* v. *Mississippi Tax Commission*, 412 U.S. 363, 380.

case in which taxes have been held preempted by implication.) *McGoldrick* may have been called into question by *Department of Revenue* v. *Association of Washington Stevedoring Companies*, No. 76-1706, decided April 26, 1978. At all events the United States believes that *McGoldrick* involves both a clear statement of congressional purpose and a clear frustration of that purpose by the state tax, which makes it quite unlike the present case. *Warren Trading Post* is irrelevant here, in the view of the United States, because it involves taxation of Indians. Such cases always have been treated as problems of inter-governmental tax immunity rather than as problems of ordinary preemption. See, *e.g.*, *Moe* v. *Confederated Salish and Kootenai Tribes*, 425 U.S. 463.

CONCLUSION

The Commission submits that the Court should note probable jurisdiction and reverse the judgment below. The United States submits that the appeal should be dismissed for want of a substantial federal question.

Respectfully submitted.

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JUNE 1978.

☆ U. S. GOVERNMENT PRINTING OFFICE; 1978 268237 49